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In the Supreme Court of the United States

OCTOBER TERM, 1941.

Nos. 641 and 642.

THE GLIDDEN COMPANY
and
UNITED STATES GUARANTEE COMPANY,
Petitioners,

vs.

THE UNITED STATES OF AMERICA.

(Two Actions, Nos. 8652 and 8653, in the Circuit Court and Nos. 18,119 and 18,145 in the District Court.)

REPLY BRIEF FOR PETITIONERS.

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Government's Misleading Statement of Questions.

The petitioners have not contended either (1) that the prior judgment is *res judicata* of the claim for recovery on the bonds respectively of $4.50 or $2.00 per wine gallon if and as primary covenants for liquidated damages, or (2) that the Commissioner of Internal Revenue lacked authority to issue regulations requiring the execution of bonds to secure compliance with permits to obtain denatured alcohol tax-free for industrial purposes and payment of legally collectible diversion taxes, penalties and fines.

Those are *straw-man* "questions presented" and answered in the opposing brief in lieu of an answer to the *actual* "questions presented" as stated in the petitions for writs of certiorari (p. 2).

Res Judicata Affecting the Government's "First" Counts.

The petitioners plead the former case (*United States v. Glidden Co., et al.,* 78 F. (2d) 639, cert. den. 296 U. S. 652) as *res judicata* with respect both to the government's "first" counts to collect the basic distiller's tax and also its "second" counts to enforce the alleged liquidated damage clause if, but only if, construed as a unit limit of indemnity clause instead of as a liquidated damage clause.

Perhaps the petitioners should understand that the government has abandoned its said "first" counts and is willing to have them stricken from its amended petitions. If not, the plea of *res judicata* is important in the first instance in connection with those counts and the authorities cited in the government's brief at pages 7 and 8 are not only not on the point but hold contrary to the government's claim in those counts. (See especially *United States v. Bornn,* 104 F. (2d) 641, at p. 647, cert. den. 308 U. S. 606; and *United States v. Van Schaack Bros. Chem. Works, Inc.,* 33 F. Supp. 822, syl. 4.)

The judgment in the prior *Glidden* case, cited above, adjudicated that the principal defendant herein was not liable either for the diversion penalties or the basic distiller's taxes by reason of the identical alleged diversions now charged in these suits on the bonds. (See the record in said prior case, particularly the pleadings and journal entries and the government's petition for writ of certiorari and reply brief thereon, said petition pages 5 and 6 and said reply brief pages 1 and 3, as the Court may do under *Debearn v. Safe Deposit & Trust Co.,* 233 U. S. 24 and *Oklahoma v. Texas,* 256 U. S. 70, 88.)

The So-Called Liquidated Damage Clause was Invalid.

Now, in the "second" counts on each of the several bonds in the pending cases, the government seeks to hold the same principal and its surety liable on the bonds, heretofore conceded and held to be bonds of indemnity, under a clause claimed to be a liquidation of the liability for the same tax (as aforesaid, not levied or chargeable against such principal) on the same alcohol as to which the principal defendant was exonerated in said prior case.

As of the period when the bond form was prepared and adopted and with respect to bonds issued before the Revenue Act of 1926, it was held in *United States v. Bornn, supra,* that the $4.50 per wine gallon clause was enforcible as a liquidation of the basic distiller's tax rate of **$2.20** per proof gallon which was current at the time the bonds in that case were given (notwithstanding it was liquidation of a tax for which the principal was not liable!). Prior to the 1926 amendment a non-distiller-diverter was (by legislative oversight) not liable for either the basic taxes or the diversion penalties, and except for the $4.50 unit penalty in the bond form would have escaped scot-free. That legislative oversight was remedied by the 1926 amendment to the Revenue Act, so that the principal, upon diversion, became liable for the heavy $6.40 per proof gallon (about $12.80 per wine gallon) penalties and the old pre-1926 form of bond became obsolete insofar as it required the payment of $4.50 per wine gallon *in addition* to the 1926 statutory penalties of $6.40 per proof gallon. The latter then became the exclusive liability of a non-distiller-diverter, and the actual damages recoverable under the bonds as well, except for occurrences subsequent to the alleged diversions which in the *Glidden* cases exonerated the principal from such liability.

After the Revenue Act of 1926 the $4.50 and $2.00 unit bond provisions were inadvertent, unenforcible attempts to

superimpose a stipulated penalty on top of the actual statutory penalty. After the 1926 Act the bonds could not be of the character considered in *United States v. Frost,* 80 F. (2d) 341 and other primary or forfeiture bond cases cited by the government. What right or power did the executive department have to fix a lesser rate to be collected either in addition to or without regard to the collectibility of the amount fixed by the Congress? The Congress had preempted the field of taxes, penalties and liquidated damages assessable against a manufacturer other than a distiller.

The government does not attempt to distinguish the case of *United States v. Tingey,* 9 U. S. (5 Peters, 115, 131) 248, which the petitioners cited in their original brief. The fact that the government has not collected the statutory penalty of $6.40 per proof gallon is not a distinction of any character. The Commissioner either had or did not have power and authority to add to or detract from the penalty and liquidated damages prescribed by the Congress and, if he did not have such power and right, collateral circumstances with respect to collection or non-collection of the amount fixed by the Congress are irrelevant.

It is well settled, and conceded, that these bonds are bonds of indemnity to secure the revenue, and when the Congress prescribes the taxes or penalties, or both, which are recoverable from the principal, in the event of breach, those statutory taxes and penalties are the actual damages, and the measure, and the exclusive measure, of the recovery under the bonds. (*United States v. Zerbey,* 271 U. S. 332.)

In *United States v. Stein,* 119 F. (2d) 677, cert. den. No. 524 present term, and *United States v. Bornn, supra,* it does not appear from the reports that there had been any prior judgment exonerating the principal defendant or that the points now raised by the petitioners in the pending cases were presented or considered.

The $4.50 and $2.00 unit clauses fail as enforcible liquidated damage provisions, not because that particular question is *res judicata* (respondent's straw-man), but because *a contract penalty cannot be super-imposed on or substituted for statutory penalties.*

Res Judicata Affecting the Government's "Second" Counts.

The prior judgment, of course, did not adjudicate anything about recovery at the $4.50 or $2.00 rates per wine gallon specified in the so-called liquidated damage clauses of the bonds, because the bonds were not considered, or even mentioned, in the prior suit.

In the *Van Schaack* case, *supra,* the current basic distiller's tax rate was $1.65 or $1.10 per proof gallon, as in the pending *Glidden* cases, and the court held that the $4.50 bond clause was arbitrary, excessive and beyond the power of the Commissioner of Internal Revenue but, inconsistently with its decision in the same opinion that industrial manufacturers were not liable for basic distiller's taxes, that damages at such basic distiller's tax rates could be collected under the clause *as a unit limit of indemnity* rather than as a liquidated damage provision.

If the government should attempt (inconsistently) to change the theory of its "second" counts to that of the court in the *Van Schaack* case, it is important to note: (1st) That the Commissioner lacked power to fix a lesser unit limit of indemnity than $6.40 per proof gallon for the same reasons given hereinbefore; (2nd) That he did not purport to fix any other limit of indemnity than the lump sum limits of the bonds; (3rd) That if the clause is only a unit limit of indemnity the basic distiller's taxes cannot be collected under it for the reason that the bond was not worded or given to secure taxes levied on others than the principal; and (4th) That in the pending *Glidden* cases *the principal*

defendant has been exonerated by the judgment in the prior case from that measure of damages even if it were otherwise collectible under the clause as a unit limit of indemnity.

Respectfully submitted,

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Rec'd.